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UNCLAS SECTION 01 OF 03 SAO PAULO 000214

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STATE PASS USTR FOR KDUCKWORTH
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SUBJECT: BRAZILIAN STOCK EXCHANGES GET GREEN LIGHT FOR MERGER

SENSITIVE BUT UNCLASSIFIED--PLEASE TREAT ACCORDINGLY

REF: A. SAO PAULO 0115

[B](#). 07 SAO PAULO 0899

[11.](#) (U) SUMMARY: Brazil's two stock exchanges announced their intent to merge on March 27. The merger of the Brazilian stock exchange (Bovespa) and the Commodities and Futures Exchange (BM&F) into BM&F Bovespa, S.A. will make the new exchange the third largest in the world in terms of market value. The merger should bring down administrative and transaction costs and allow the combined company to trade in a broader range of products and to compete more effectively with global exchanges such as NYSE-Euronext. The merger should also further consolidate Brazil's position as an important emerging market economy and strengthen its financial system. Post has good relations with both BM&F's CEO Manoel Felix Cintra Neto and Bovespa's Chairman Raymundo Magliano Filho, the two frontrunners to lead the combined BM&F Bovespa. END SUMMARY.

The Merger

[12.](#) (U) On March 27, Brazil's two stock exchanges, Bovespa and the Commodities and Futures Exchange (BM&F), announced their merger into what will be called BM&F Bovespa. The announcement follows their initial statement of merger talks on February 19 (ref A), and came well before their self-imposed 60 day deadline. Last year, both companies held initial public offerings (IPO), and their exchanges had record-breaking years. Bovespa Holding raised USD 3.8 billion in October (ref B), which was the largest IPO in Brazil's history. One month later, BM&F raised USD 3.4 billion. The merger will make the new exchange the third largest in the world in terms of market value, with an estimated combined value of USD 20 billion, behind only the Chicago Mercantile Exchange Group/New York Mercantile Exchange (USD 36 billion) and Germany's Deutsche Borse (USD 32 billion).

[13.](#) (SBU) Bovespa's CEO and Director of Investor Relations Gilberto Mifano told the Consul General that the two companies will retain their separate brand names under one umbrella holding to be called BM&F Bovespa. (Note: Earlier press reports suggested the company would be called Nova Bolsa, or New Exchange in Portuguese. End

Note.) On May 8 the majority shareholders will elect one Chairman, likely either BM&F's Manuel Felix Cintra Neto or Bovespa's Chairman of the Board of Directors, Raymundo Magliano Filho. Cintra Neto told Econoffs that he would return to his banking business if he was not chosen to lead the combined entity, but opined that should he be appointed, he would like for Magliano to stay at the company, particularly in light of his expertise in corporate social responsibility.

Leveraging Lessons Learned and Existing Partnerships

¶ 14. (SBU) BM&F Bovespa, the fourth such merger of exchanges in recent history, is taking advantage of lessons learned. In October 2007, the Chicago Mercantile Exchange Group (CME) purchased 10 percent of BM&F in exchange for two percent of the CME. Cintra Neto noted to Econoffs that the CME has provided integral support to BM&F as it undergoes the merger. Cintra Neto stated that there are currently 10 to 12 BM&F staffers at CME, and that these ongoing personnel exchanges will facilitate the merger.

¶ 15. (SBU) Cintra Neto also told Econoffs that, unlike the recent mergers of the New York Stock Exchange (NYSE) with Euronext and the CME's merger with the New York Mercantile Exchange, BM&F Bovespa intends to integrate the two companies' administrative functions where possible, including eliminating one CEO. Cintra Neto criticized similar mergers for not leveraging synergies to reduce costs. Cintra Neto further stated to Econoffs that the BM&F Bovespa union should be a more seamless merger. Unlike NYSE and Euronext, for example, BM&F and Bovespa have overlapping clients and shareholders, a common language and business culture, and are physically located across the street from each other, all of which should facilitate an earnest integration of the two companies.

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Cost Cutting

¶ 16. (SBU) Bovespa and BM&F executives intend to leverage existing synergies and eliminate administrative duplication. BM&F Bovespa hopes to integrate the company's electronic trading platforms, as well as its clearance and settlement activities. The two companies have an aggressive goal of reducing combined overhead costs by 25 percent within three years. Cintra Neto remarked to Econoffs that approximately 90 percent of costs are for either IT systems or payroll. To maximize cost cutting benefits, BM&F Bovespa plans to slash personnel, especially in administrative and information technology. Cintra Neto stated that BM&F Bovespa plans to honor stock option vesting commitments for all employees they dismiss.

¶ 17. (U) Bovespa's Mifano told Econoff that he anticipates a reduction in costs to investors as well. The two exchanges have significant client overlap and BM&F Bovespa would be able to manage all transactions under one roof and pass these savings on to customers. Although Bovespa's transaction and administrative costs are higher than other exchanges, Mifano noted that Bovespa is a vertically integrated exchange and its overall costs (about three percent of total daily trading volume) are on par with peer exchanges. (Note: Brazil's strict transparency rules require Brazilian exchanges to manage clearing and settlement functions in-house. Bovespa's fees include all transactions, clearing, and settlement costs, while traditional exchanges only levy transactions fees and brokers' fees tend to include clearing and settlement costs. End Note.)

Awaiting Approval

¶ 18. (U) The Boards of Directors of the two companies approved the merger on April 17 and both executives told Econoffs that the other approvals are forthcoming. The Central Bank gave its informal blessing (but still needs to formally approve) to consolidate four clearance and settlement functions into one entity despite some misgivings about concentrating those efforts. Similarly, Mifano

told Econoff that the Brazilian Securities and Exchange Commission (CVM by its Portuguese acronym) also should have no problems with the merger as it simplifies their supervision of the two exchanges. Finally, the Brazilian antitrust regulator (CADE) must sign off. As the two companies were never competitors, they do not anticipate that their merger would create an anti-monopoly backlash.

BM&F's Vision for Regional Integration

¶9. (SBU) While the merger helps BM&F Bovespa (and by extension Brazil) better position itself to compete with other modern exchanges, both exchanges are predominately domestic and BM&F Bovespa is working to partner with other exchanges to increase its competitiveness in the global marketplace. Cintra Neto noted that BM&F has always had a collegial relationship with U.S. exchanges and BM&F's Director of Investor Relations Joao Lauro Amaral stated that BM&F's agreement with CME helps link BM&F to the U.S. market. As a result, the two exchanges have an order routing agreement whereby BM&F and CME distribute each other's derivatives products on their respective local markets. Cintra Neto further explained that BM&F trades its Brazilian soy futures contracts on CME's exchange and is helping CME establish American soy futures contracts in Brazil as well. Cintra Neto affirmed that BM&F had been in talks with NYSE's former CEO John Thain to exchange shares while holding ongoing talks with CME, but that a merger with Bovespa would have been impossible if BM&F had opted to cut a deal with the NYSE instead. BM&F does have agreements with the NYSE, however, as well as with exchanges in Mexico, China, and Argentina. BM&F is also an active participant in the Futures Industry Association in Washington and the U.S Commodity Futures Trading Commission.

¶10. (SBU) Cintra Neto said that BM&F is not currently interested in buying exchanges in the region. Instead, he prefers the model it has with the CME of sharing electronic platforms and resources. Cintra Neto told Econoffs that BM&F is committed to helping the rest

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of Latin America develop its financial systems via technology transfers and exchanging business "know-how." Cintra Neto mentioned that despite the Argentine exchange's recent descent, it continues to have a strong agricultural commodities exchange in Rosario. He noted that BM&F is working with the Argentines to develop Brazil-Argentina soy futures contracts, which BM&F hopes will attract Chinese investors. (Note: BM&F acts as an intermediary between buyers and sellers, especially for the Chinese. According to Cintra Neto, Chinese importers do not trust Latin American agriculture producers to deliver their merchandise and Brazilian producers in turn are afraid Chinese importers will not pay. BM&F's futures derivatives facilitate the Brazil/Argentine-Chinese agriculture trading. End Note.)

COMMENT

¶11. (SBU) BM&F Bovespa has a healthy approach to managing their merger, which has clearly been in process since before each company's IPO last year. Both Cintra Neto and Magliano are capable and impressive businessmen with whom post has regular contact. Despite external market turbulence, both Brazilian exchanges have out-performed other emerging markets and the merger should further consolidate Brazil's position among emerging market economies and help strengthen Brazil's already solid financial system. END COMMENT.

¶12. (U) This cable has been cleared with Embassy Brasilia and coordinated with the US Treasury Financial Attaché in Sao Paulo.

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